

customers), we suspect that most of the 8% decline at the gross margin level will fall to and magnify at the pretax and after tax lines as well. In short, 10% share loss for the long distance companies could translate into 8% gross margin loss and an even greater percentage of profits. (And, if the RBOCs self-supply long distance capacity, or hand inter-regional traffic to each other, the losses would increase even further.)

This will put enormous pressure on the long distance carriers to try to offset the losses by either additional headcount cuts and/or new business ventures, including capital intensive and dilutive forays into building or buying their own local telephony facilities — the latter another reason for our bullish view of those with local network infrastructure already in the ground, such as MFS.

How the Telecom Act of 1996 Works

RBOCs Could Begin Offering Out-of-Region and Cellular Long Distance Immediately; Our Guess for In-Region Long Distance is About 1 1/2 to 2 Years

We believe the final details of the Act and its provisions for RBOC entry into long distance, local resale, joint marketing of services, and requirements for a separate subsidiary benefit are far more favorable for the RBOCs than many realize. Indeed, we believe many RBOC executives and lobbyists remain quietly amazed at how the shift from last year's Democrat-controlled to this year's Republican-controlled Congress resulted in a significant weakening of the facilities-based competition precondition, delayed AT&T's MCI's and Sprint's joint marketing of local and long distance services and delayed intra-LATA toll dialing parity for states in which it had not yet been ordered. (Appendix 1 details the key provisions of the law).

According to the new law, without any preconditions the RBOCs can offer long distance service *out-of-region* via a separate subsidiary and also can—for the first time—*bundle cellular and local service in-region*. While these new freedoms are nice, we do not expect to be increasing our EPS or growth estimates given the small size of the cellular long distance market (only about \$1.5 billion of the \$68 billion long distance market) and the limited way in which we expect RBOCs to seek out-of-region market share.

However, in order to offer long distance service *in-region* in a given state, an RBOC must meet the 14-point open interconnection checklist and prove the existence of a facilities-based competitor in both the business and residential markets. We think it will take about 1 1/2 years until the first RBOC (probably NYNEX in NY or Ameritech in Illinois or Michigan) has met the preconditions and received the FCC's approval to offer in-region long-distance. GTE, however, is not required to meet the checklist, facilities-based competitor precondition nor the public interest test and thus can offer long distance service almost immediately to its in-region customers and is not forced to sell long distance through a separate subsidiary.

Incremental Profits From Long Distance Opportunity are Very Attractive.....

The incremental profits to be realized from long distance entry are significant and the up-front dilution to enter the business will be negligible. This is because the RBOCs and GTE can offer long distance service with very low capital investment, very little construction time, very strong brand from the starting gate, and the industry's highest volume and thus strongest buying power for leased wholesale long distance capacity. Therefore, an RBOC will be able to bargain for huge volume discounts that are likely to grow over time as RBOC long distance share and thus negotiating leverage grows.

...Driven by Huge Discounts on Wholesale Long Distance Transport

As discussed above, we believe in the near-term, long distance companies will continue to announce contracts to provide RBOCs with long distance transport (net of access) at wholesale rates near 2 or 3 cents per minute—huge 70-80%

discounts off the 10 cents (net of access) currently collected by the long distance companies from retail customers. The RBOCs will likely focus their efforts on and gain most share in the consumer and small business markets, where the profit margins are significantly higher than the already deeply discounted and highly competitive large business market. (Incidentally, AT&T's revenue and profit mix is disproportionately exposed to the consumer segment.) A bonus for some RBOCs, especially NYNEX, Pacific Telesis and SBC, will be access to the international long distance market — the market with the highest profit per minute in the industry.

and Low Upgrade Cost

The incremental margins will be even more attractive if the RBOCs use their own switches and fiber optics to carry in-region calls from, e.g., Los Angeles to San Francisco or D.C. to Philadelphia—in effect, taking a long distance company's retail yield of \$0.10/min. to zero. This would not be a difficult undertaking given that RBOCs already have some capacity in place, switch upgrades are not expensive relative to current RBOC capital budgets and 40% of all long distance minutes originate and terminate in the same region. Even worse would be if 2 or more RBOCs agree to send traffic to each other—thereby increasing the 40% number to much higher and increasing the bypass risk to the long distance networks. This — along with potential synergies from redundant staff, overhead and even some field operations — is the driving factor behind recent speculation of consolidation among the RBOCs.

Incremental Profits for Competitors Entering Local Market Much Less Attractive...

Conversely, the opposite is true for long distance companies or other competitors entering the local market — Local market entry will be very expensive and time consuming and the wholesale discount for local resale will be much less attractive from the following reasons:

Details on Rules for Local Resale

■ **Bundled Local Resale Rates Will Enable RBOCs to Recover 70-80% of Share Loss:** RBOCs will be required to resell fully bundled local service (i.e., the full complement of local monthly service, measured service, access) at "retail price less sales and marketing and other avoided costs". This is about the best definition an RBOC could ask for, as they will have to deduct only avoidable costs. Some have argued the RBOCs will deeply discount the bundled resale price because otherwise companies like AT&T will accelerate their facilities-based bypass investments. While we believe there is some merit to this argument, we expect the RBOCs to target their price cuts only to those areas about to be besieged by such bypassers. Given the long lead times and huge capital investments needed to build out local networks, and given AT&T's apparent reluctance to hit investors with unexpected dilution, we suspect the trend downward from 20-30% discounts will be a gradual one, not the cataclysmic one envisioned by some.

■ **Unbundled Local Resale Is Not A Cream-Skimming Opportunity:** RBOC competitors will be allowed to buy local network elements and features (e.g., last mile, switching, 911 and 411 services, etc.) at "cost plus a reasonable profit". Given that the last mile, which is the hardest part of the local network for new competitors and resellers to replicate, is currently priced far below cost by any standard, it is likely resellers of unbundled elements will have to pay a premium (not a discount as implied by some) for those elements, such as the last mile, that they cannot self-provide. The real issue is how much contribution new entrants will have to make to universal service and to coverage of subsidies for local line rentals—i.e., will new entrants be able to cream-skim underneath the unbalanced rate structure? This is handled in separate provisions and will be decided by state and federal regulators together, and is obviously a huge issue in terms of dollars. With the cost-plus profit concept written into the Conference Report, state regulators involved, as well as the

dominant role of rural Senators, we are quite comfortable that RBOCs will not find themselves being creamskimmed by new entrants taking advantage of politically-forced, unbalanced rate structures.

No Joint Marketing of Services by LD Cos and Intra-LATA Dialing Parity Delayed Until RBOCs Allowed into LD

In addition, long distance carriers' opportunity to gain share and profits in the intra-LATA toll market will be delayed as a result of provisions that, with the exception of 28 "grandfathered" states, would forestall the implementation of dialing parity rules until an RBOC has been given approval to provide long distance or until 3 years have passed, whichever is earlier.

Finally, the long distance companies will also not be allowed to bundle local and long distance until the RBOCs are allowed to offer long distance. However, they continue to be allowed to offer long distance (inter-LATA) and toll (intra-LATA) calling as a package in those states allowing intra-LATA toll competition.

The New Law Will Continue to Lead to Announcements that Support Our Conclusions:

We believe the next 6-9 months will continue to bring many announcements by the RBOCs/GTE and long distance companies that will raise investor awareness of the risks for long distance carriers and the opportunities for the RBOCs/GTE.

Indeed, Soon After President Clinton Signed the Bill, The Following Announcements Were Made Which Reinforce Our Views:

GTE's Long Distance Goal: 10% Market Share Within 12 Months

1. GTE's disclosure at its regular quarterly meeting that it expects to be offering long distance services to its in-region customers before the first quarter ends and intends to gain 10% of its addressable long distance market within 12 months and at the same time maintain its 10% EPS growth objective for the foreseeable future;

Cellular LD Offered by Several RBOCs & GTE

2. The immediate offering of long distance service to cellular customers by Ameritech, BellSouth, Bell Atlantic/NYNEX Mobile, Southwestern Bell Mobile and GTE,

Wholesale Contracts With WorldCom and LCI

3. These same companies announcing volume and term contracts with Worldcom and LCI for wholesale long distance capacity at rates that are surely in the 2-4 cent/minute range; scaling down to the lower end of that range as volume thresholds are met;

Share Gains and Attractive Wholesale/Retail Spread in Cellular LD Highlights Landline Opportunity

4. Ameritech's indication a week ago that it had already converted 7% (probably more now) of its 1.9 million cellular customers from AT&T, MCI, Sprint, etc. to Ameritech's long distance service which means going forward Ameritech — no longer the long distance companies — will reap the profitable arbitrage between retail cellular long distance rates of 20-30 cents/minute (net of access) and the 2-4 cent wholesale cost (also net of access). We note cellular long distance accounts for only 2-3% of the \$67 billion long distance market and the RBOCs are unlikely to convert more than 25% of their cellular customers. For these reasons, we view cellular long distance as only a small opportunity for the RBOCs and a small threat to the long distance carriers. Nevertheless, it serves to highlight the retail versus wholesale price arbitrage opportunity made available to the RBOCs by the legislation and by the RBOCs' buying power vis a vis 4 long distance network suppliers. It also serves to highlight the risk of commoditization that long distance companies will experience to the extent the FCC approves RBOCs' offering long distance service to in-region wireline customers and to the extent the RBOCs gain long distance market share;

FCC Rapid Publication of
Rules For RBOCs
Reviews, Out of Region
LD Applications Already
Filed by BEL and SBC

5. The FCC's rapid publication of proposed rules for reviewing RBOC applications to provide long distance service to out-of-region customers. In this regard, Bell Atlantic has announced plans to offer service in 5 states (Texas, Florida, South and North Carolina, and Illinois) and SBC announced plans to do the same in those portions of 16 out-of-region states in which it operates Cellular One. SBC intends to offer a bundled package of cellular, long distance and possibly local services — all under the well-established Cellular One brand. So much for the lack of out-of-region brand power for this RBOC, at least!

Table 3
Recent Stock Performance
(As of February 16, 1996)

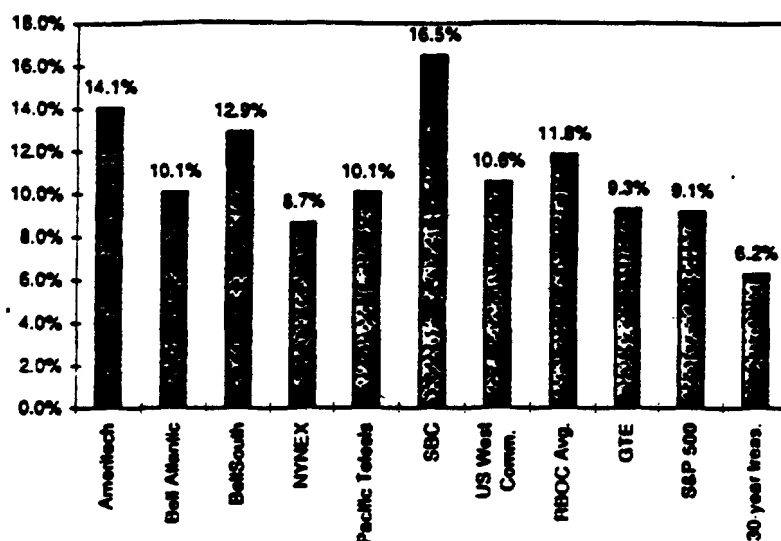
Company	Price @ 2/16/96	Price Appreciation Since												
		7/1/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95	12/31/95
Ameritech	\$59.53	31.0%	78.7%	87.8%	67.4%	55.4%	47.7%	1.3%	88.7%	52.2%	44.5%	35.3%	14.4%	5.1%
Bell Atlantic	\$68.38	24.6%	27.5%	41.7%	33.4%	15.4%	37.4%	2.2%	53.7%	24.0%	29.3%	22.1%	11.4%	-0.5%
BellSouth	\$40.38	29.2%	47.5%	56.0%	57.2%	38.2%	49.2%	-7.2%	63.5%	42.9%	35.7%	27.2%	10.4%	-4.4%
NYNEX	\$52.13	28.3%	46.6%	29.1%	24.3%	29.9%	41.8%	-3.5%	32.2%	14.7%	32.0%	29.5%	9.2%	3.5%
Pacific Telesis	\$30.25	16.9%	NA	NA	NA	NA	6.1%	-9.7%	NA	NA	0.0%	13.1%	-1.8%	-9.0%
SBC Comm.	\$55.75	21.2%	99.1%	72.5%	50.7%	34.3%	38.1%	-2.6%	82.8%	42.9%	32.7%	17.1%	1.4%	0.0%
U S WEST (Media & Comm.) [1]	\$55.00	33.3%	41.5%	45.2%	43.3%	19.9%	54.4%	0.7%	50.7%	25.7%	37.1%	32.1%	16.4%	2.6%
U S WEST Comm.	\$34.00	NA	NA	NA	NA	NA	NA	-4.8%	NA	NA	NA	NA	NA	-1.4%
RBOC Average [2]		26.4%	56.8%	55.4%	46.0%	32.4%	39.3%	-3.4%	62.1%	33.7%	30.2%	25.2%	8.8%	-1.0%
GTE	\$45.00	29.5%	53.8%	30.0%	30.0%	28.6%	48.1%	2.8%	41.2%	20.4%	35.3%	31.9%	15.0%	0.6%
S&P 500	648	16.0%	96.2%	55.3%	42.7%	38.9%	41.1%	5.2%	58.3%	46.9%	29.4%	18.9%	10.9%	7.7%
30-Yr Treas. Index Value	126	4.2%	16.8%	8.3%	9.4%	-2.0%	19.6%	-4.5%	13.3%	4.8%	-14.4%	3.6%	2.4%	-2.0%

[1] For comparative purposes only, U S WEST price is the sum of current Communications Group (USW) and Media Group (UMG) stock price

[2] Average includes U S WEST Communications only in those periods where it is available, otherwise it includes Media & Communications combined

**RBOCs Clearly
Offer Better Total
Return Potential
than the S&P 500
and the Long Bond**

**Chart 1
Total Return Potential***



* Merrill Lynch estimate.

**Table 4
5- Year EPS Growth Forecast and Potential Dividend Growth***

Company	EPS			Dividends		
	1998	2000E	5-year CAGR	1998	2000E	Implied CAGR
Ameritech	3.41	5.48	10.0%	2.00	3.30	10.5%
Bell Atlantic	3.88	6.25	10.0%	2.80	3.75	6.0%
BellSouth	2.24	3.60	10.0%	1.38	2.16	9.4%
NYNEX	3.28	4.82	8.0%	2.36	2.89	4.1%
PacTel	2.46	3.14	5.0%	2.18	2.51	2.9%
SBC	3.08	5.19	11.0%	1.65	3.11	13.5%
US West	2.35	3.30	7.0%	2.14	2.64	4.3%
RBOC Avg.			8.7%			7.2%
GTE	2.81	4.02	9.0%	1.88	2.41	5.1%

*Assumes achievement of 5-year EPS growth and targeted payout ratio of 60% by year 2000 (80% for Pacific Telecst and U S WEST Communications).

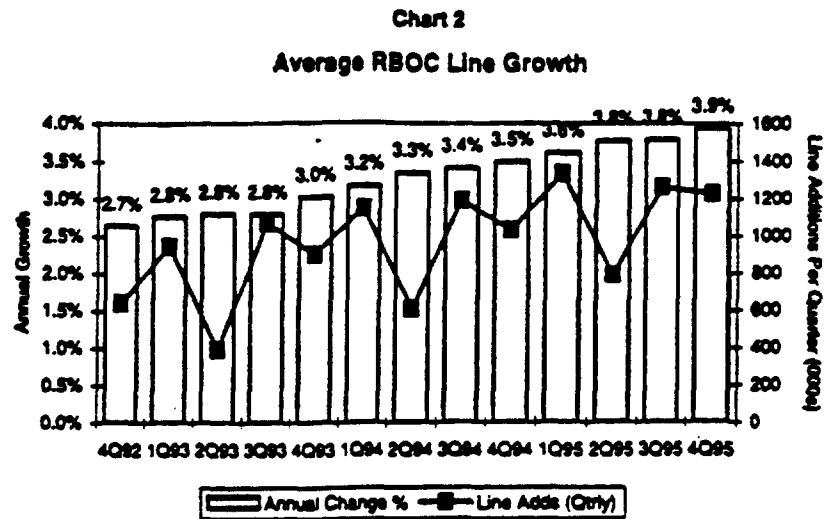
Table 5
Total Return Potential*

Company	(a) Implied Div Growth	(b) Current Yield	(c) Total Return	(d) Relative Tot Ret*	(e) Rel P/E 95 EPS	(e)/(d) Rel. P/E to Rel. Tot. Ret.	Tot Return: P/E
Ameritech	10.5%	3.6%	14.1%	1.54	1.01	0.85	80.4%
Bell Atlantic	6.0%	4.1%	10.1%	1.11	1.01	0.91	57.4%
BellSouth	9.4%	3.8%	12.9%	1.42	1.04	0.73	71.6%
NYNEX	4.1%	4.5%	8.7%	0.95	0.91	0.96	64.6%
Pacific Telesis	2.9%	7.2%	10.1%	1.10	0.71	0.64	82.0%
SBC	13.5%	3.0%	16.5%	1.81	1.04	0.58	91.2%
US West Comm.	4.3%	6.3%	10.6%	1.16	0.83	0.72	73.0%
 RBOC Avg.	 7.2%	 4.6%	 11.8%	 1.30	 0.94	 0.72	 72.8%
 GTE	 5.1%	 4.2%	 9.3%	 1.02	 0.98	 0.98	 53.7%
S&P 500	7.0%	2.1%	9.1%	1.00	1.00	1.00	52.5%
30-year treas.	0.0%	6.2%	6.2%				

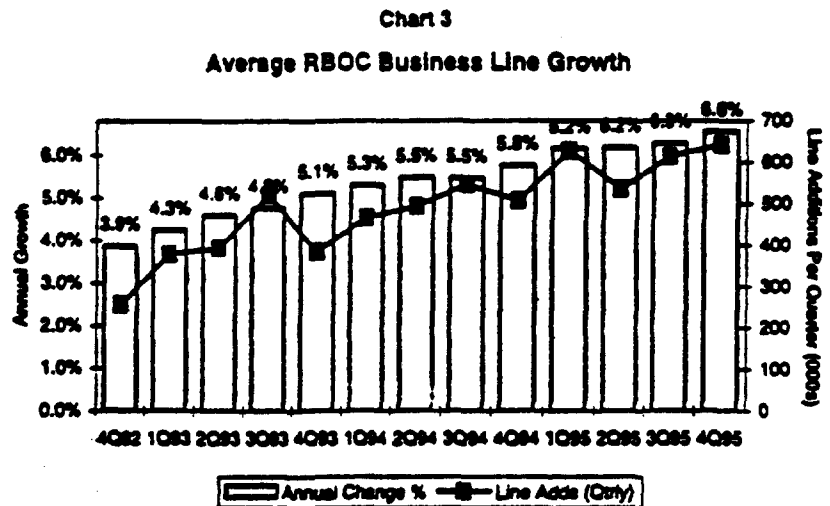
Average Total Return 560 b.p.
above the long bond.

*Merrill Lynch estimate; theoretical total return, assuming all RBOCs and GTE achieve a targeted payout ratio of 80% by 2000 (PAC and USW target of 80%).

RBOC Line Growth Accelerated in 4Q95



Strong Business Line Growth



Minute Growth Decelerated

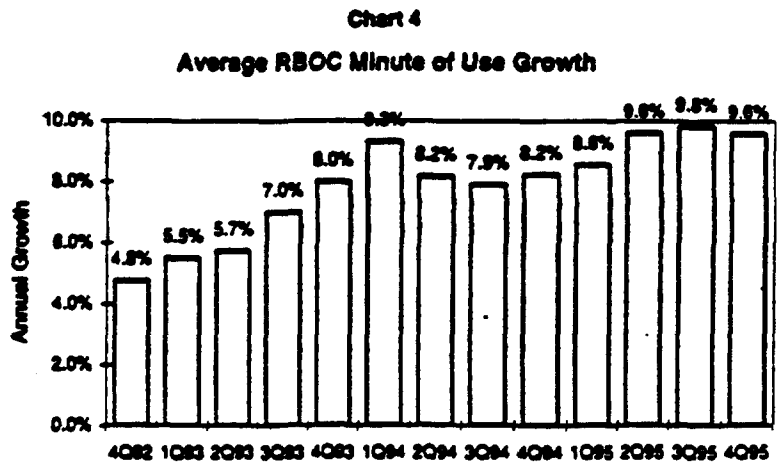


Table 8

Access Line and Minute Volumes
(Year-Over-Year % Growth By Quarter)

	Total Lines					Access Minutes				
	4Q84	1Q85	2Q85	3Q85	4Q85	4Q84	1Q85	2Q85	3Q85	4Q85
AIT	3.9%	3.8%	4.2%	4.4%	4.5%	6.9%	6.9%	8.7%	8.7%	9.1%
BEL	2.8%	2.9%	3.1%	3.3%	3.4%	8.0%	6.8%	8.6%	8.3%	8.2%
BLS	4.6%	4.6%	4.8%	4.7%	4.5%	9.5%	8.9%	9.6%	9.7%	9.0%
NYN	3.3%	3.3%	3.2%	3.0%	3.4%	7.8%	6.0%	9.0%	9.4%	10.4%
PAC	3.0%	2.8%	2.9%	2.7%	3.0%	6.7%	10.8%	10.7%	11.0%	11.0%
SBC	3.6%	3.6%	4.0%	4.2%	4.5%	10.2%	11.0%	11.1%	11.3%	10.0%
USW	3.3%	4.2%	4.2%	4.2%	4.2%	8.7%	9.6%	9.4%	10.3%	9.3%
RBOC Avg	3.5%	3.6%	3.8%	3.8%	3.9%	8.2%	8.6%	9.6%	9.8%	9.6%
GTE*	4.9%	5.1%	5.4%	5.7%	5.2%	9.3%	7.5%	10.3%	9.9%	10.7%

* Includes International Lines.

Table 9

RBOC Access Line Growth by Segment and Quarter
(Year-Over-Year % Growth By Quarter)

	Residential Line Growth					Business Line Growth				
	4Q84	1Q85	2Q85	3Q85	4Q85	4Q84	1Q85	2Q85	3Q85	4Q85
AIT	2.4%	2.3%	2.6%	2.9%	3.1%	6.9%	7.0%	7.2%	7.2%	7.2%
BEL	2.1%	2.0%	2.1%	2.2%	2.4%	4.3%	4.8%	5.2%	5.5%	5.5%
BLS	3.7%	3.4%	3.7%	3.5%	3.2%	7.1%	7.7%	7.7%	7.7%	7.9%
NYN	1.9%	1.8%	1.9%	1.8%	1.8%	6.5%	6.5%	6.1%	5.8%	6.7%
PAC	2.1%	2.2%	2.2%	1.8%	2.1%	4.3%	4.4%	4.1%	4.4%	4.9%
SBC	2.3%	2.3%	2.7%	2.8%	3.1%	6.8%	6.9%	7.0%	7.4%	7.8%
USW	3.6%	3.7%	3.6%	3.6%	3.6%	5.0%	5.7%	5.9%	5.9%	5.9%
RBOC Avg	2.6%	2.5%	2.7%	2.7%	2.8%	5.8%	6.2%	6.2%	6.3%	6.6%

Table 6
RBOCs and GTE
Fourth Quarter Earnings Comparisons 1995 vs 1994

	Recurring			Reported QOE	One Time Charges
	1995	1994	% Chg		
Ameritech	0.80	0.81	11.2%	0.75	0.16
Bell Atlantic	0.80	0.76	18.4%	0.89	0.01
BellSouth	0.57	0.52	8.7%	-0.16	0.73
NYNEX	0.88	0.78	12.3%	0.55	0.33
Pacific Telesis	0.54	0.82	(12.5%)	0.54	0.00
SBC	0.83	0.77	8.0%	0.85	-0.02
U S WEST Comm	0.57	0.80	(5.2%)	0.80	-0.03
RBOC Avg			5.8%		
Excl. PAC and USW			8.0%		
GTE	0.74	0.67	10.4%	0.73	0.00

Table 7
RBOCs and GTE
Recurring Annual EPS Comparisons 1994-1997E*

	1994E	1995E	1996M % Chg	1996E	1997MSE % Chg	1997E	1998MSE % Chg
Ameritech	\$3.07	\$3.41	11.2%	\$3.75	10.0%	\$4.15	10.8%
Bell Atlantic	\$3.52	\$3.88	10.2%	\$4.20	8.2%	\$4.58	8.3%
BellSouth	\$2.07	\$2.24	8.5%	\$2.45	9.5%	\$2.67	8.7%
NYNEX	\$3.01	\$3.28	8.9%	\$3.55	8.2%	\$3.85	8.4%
Pacific Telesis	\$2.76	\$2.46	(10.8%)	\$2.50	1.8%	\$2.35	(5.9%)
SBC	\$2.80	\$3.08	10.0%	\$3.42	11.1%	\$3.80	11.1%
U S WEST Comm	\$2.42	\$2.36	(3.1%)	\$2.45	4.8%	\$2.80	8.0%
RBOC Avg			5.0%		7.5%		6.4%
GTE	\$2.38	\$2.61	10.0%	\$2.87	10.4%	NA	NA

* All figures adjusted to exclude one-time items. E-Mentis Lynch Estimates.

Fourth Quarter Results In Line with Expectations

**Estimate increase for
BEL, NYN and GTE,
Decrease for USW
and PAC**

Line Growth and Minute Growth Accelerate

The RBOCs' recurring earnings in the fourth quarter were in line with expectations. Four of the seven RBOCs and GTE beat our estimates (NYNEX by \$0.04, Bell Atlantic by \$0.03, BellSouth, Pacific Telesis and GTE each by \$0.01). SBC and U S WEST were both slightly below our estimates and Ameritech reported 4Q recurring EPS equal to our estimate. The RBOCs recurring fourth quarter EPS growth averaged 5.8%, in line with the third quarter's growth and our 5.9% forecast. Bell Atlantic led the RBOCs with an EPS gain of 18.4%, followed by NYNEX (12.3%), Ameritech (11.2%), GTE (10.4%), BellSouth (8.7%) and SBC (8.0%). Pacific Telesis showed the weakest fourth quarter results with a recurring EPS decline of 12.6%. U S WEST Communications' fourth quarter EPS were down 5.2% from the year ago fourth quarter. Excluding PacTel and U S WEST, EPS growth for the remaining five RBOCs averaged an impressive 9.0% in the fourth quarter, down slightly from the third quarter's 10.3%.

Following the fourth quarter results, we raised our 1996 and 1997 estimates for Bell Atlantic (by \$0.05 each to \$4.20 and \$4.55) and for NYNEX (also by \$0.05 to \$3.55 and \$3.85). We also raised our 1996 estimate for GTE from \$2.85 to a range of \$2.85-2.90. We lowered our 1996 and 1997 estimates for U S WEST by \$0.05 each to \$2.45 and \$2.60. We also lowered our 1997 estimate for Pacific Telesis by \$0.12 to reflect greater dilution from PCS. For all seven RBOCs together, we now forecast average recurring EPS growth of 7.5% in 1996 and 6.4% in 1997. Excluding Pacific Telesis and U S WEST we forecast average growth of 9.4% in both 1996 and 1997.

Access line growth averaged 3.9% in the fourth quarter, slightly better than our forecast and the third quarter's 3.8%. High usage business line growth accelerated to 6.6%, up from the third quarter's 6.3%, while residential line growth accelerated slightly to 2.8% from 2.7% in the third quarter due to continued aggressive second line marketing campaigns by all of the RBOCs and increasing second line penetration. Roughly half of new residential lines are second lines for fax machines, home offices, children, etc. Faster business line growth relative to residential line growth is leading to an incrementally richer mix in the average RBOC's customer base. The RBOCs are also actively promoting special features such as Caller ID, Call Waiting and voice messaging to drive residential revenue and operating income per line.

GTE showed the greatest improvement in line growth, jumping 50 basis points to 6.2% from the third quarter's 5.7%, followed by NYNEX with a 40 basis point improvement, and Pacific Telesis and SBC, each with a 30 basis point improvement. GTE again led the group with total line growth of 6.2%, followed by BellSouth, Ameritech and SBC all with 4.5% line growth and U S WEST with 4.2% growth. Pacific Telesis, despite a 30 basis point acceleration, continues to lag the group with line growth of only 3.0%. NYNEX led the group in business line growth improvement, with a 90 basis point jump from 5.8% in 3Q to 6.7% in 4Q. Pacific Telesis improved 50 basis points and SBC 40 basis points. BellSouth reported the strongest business line growth, 7.9% year-over-year, up from 7.7% in the third quarter.

Average long distance minutes of use grew 9.6% year-over-year in the fourth quarter, down 20 basis points from the third quarter's 9.8%. Pacific Telesis led the group with minute growth of 11.0%, followed by GTE (10.7%), NYNEX (10.4%) and SBC (10.0%). NYNEX showed the greatest sequential improvement, jumping 100 basis points from the third quarter's 9.4% growth.

4Q Cellular Results Better Than Expected

**Average Annualized
Penetration Gain of
3.4%, Up From 3.1%
in 4Q94**

**Average Subscriber
Growth of 39% Was
Better Than Expected**

**Cellular Revenues Up
28.5%, Rev/Sub Trend
Improved**

**Operating Cash Flow
Margins Improved**

The 1995 Christmas season was one of the strongest ever in terms of net adds. The stronger than expected 4Q cellular gains were the result of more advertising and promotional expenditures relative to prior quarters. We believe the RBOCs anticipated very strong advertising campaigns from AT&T Wireless and MCI Wireless in their first Christmas season as cellular service providers and wisely opted to save their spending (as evidenced by a very weak 3Q) for extra-heavy spending in the fourth quarter.

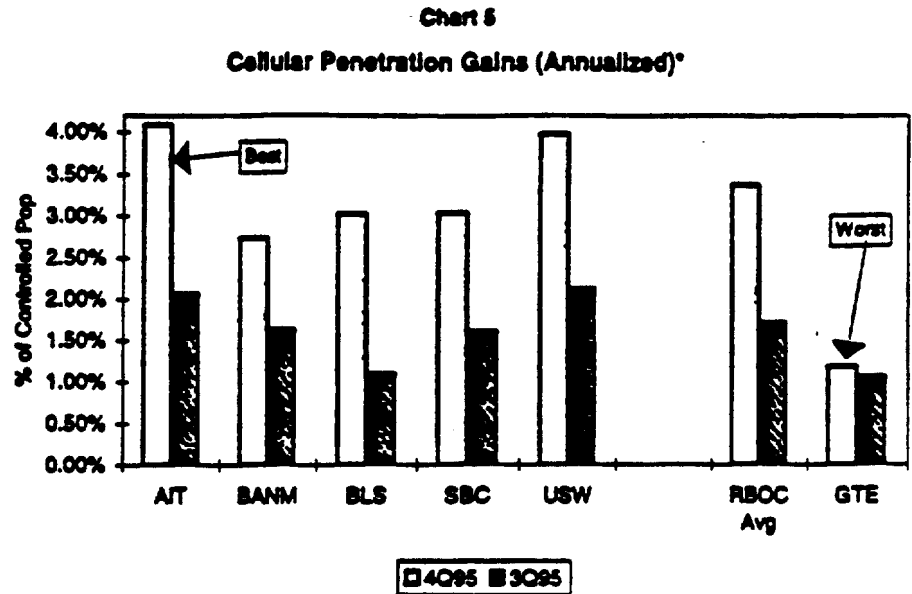
The RBOCs' cellular operations had a better than expected fourth quarter, with an average annual penetration gain of 3.38%, much better than our forecast of 3.1% and up significantly from the third quarter's 1.7% due to seasonal trends. The 3.38% penetration gain was also significantly better than the year ago fourth quarter's 2.64%. Almost all to the RBOCs reported subscriber additions were better than our forecast. The biggest surprise was from Ameritech, which led the group with an annualized penetration gain of 4.1% vs. our forecast of 3.7% and up over 100 basis points from 3.0% in the year ago fourth quarter. U S WEST New Vector (now part of U S WEST Media Group) reported the second best annualized penetration gain in the fourth quarter — just under 4.0% and also up 100 basis points from the year-ago fourth quarter. As expected, Bell Atlantic/NYNEX Mobile (BANM) reported the lowest annualized penetration gain of the RBOCs, but its 2.7% was still much better than 4Q94's 2.3%. GTE reported an annualized penetration gain of only 1.2%, down significantly from 4Q94's 2.4% as GTE (according to company management) is directing its attention toward adding "better-quality" customers and reducing its "way too high" 2.7% monthly churn rate (industry average churn is about 2%).

RBOC subscriber growth averaged 39% year-over-year, down from 42% in the prior quarter due to the larger subscriber base, but better than our 38% forecast. Average total penetration for the group is now 6.8%, led by SBC with 9.1% penetration. U S WEST New Vector reported the strongest growth with subscribers up 51.1% year-over-year and total penetration of 7.5%, followed by Ameritech with growth of 45.6% year-over-year and total penetration of 7.7%.

For the four companies that disclose revenue data, cellular revenues grew an average 28.5% annually, compared to a 39% average gain in the number of subscribers. The gap reflects an average 9% year-over-year decline in revenue per subscriber in the fourth quarter, better than the third quarter's 10% average decline. BellSouth and SBC showed the lowest estimated revenue per subscriber decline (3.2% and 5.6%, respectively), but also reported the slowest year-over-year subscriber growth due to scaled back special promotions and discounts. Contrast U S WEST, which reported the strongest quarterly gains, but a revenue per subscriber decline of 12%. BANM reported a 14% year-over-year decline, mainly due to special roaming rates along the east coast implemented in the third quarter following the BANM/NYNEX Mobile merger (\$0.59 per minute, Maine to Washington D.C) and the roll-out of special discounted local area calling plans.

For the four companies that report data, cellular operating cash flow margins averaged 37%, up from 32% in the year ago fourth quarter, but down from 43% in the third quarter due to the usual increase in customer acquisition costs in 4Q. BANM led the group with an OCF margin of 44%, a surprising improvement from 3Q's 43% and up significantly from 24% in the year-ago 4Q — evidence of the synergies the joint venture and much larger footprint can provide. BellSouth reported and OCF margin of 42%, up from 4Q94's 40%. SBC reported and OCF margin of 40%, up from 35% in the year-ago quarter. Finally, U S WEST's OCF margin dropped to 22% from 24% in 4Q94, not surprising given its strong subscriber growth (thus high customer acquisition costs) in 4Q. GTE's operating cash flow margins improved from 30.2% in 4Q94 to 36.4%.

**Annualized
Penetration Gains
Jump to 3.4%
Led by AIT and
USW, GTE Lags
Group**



**Rev/Sub Down 9%
Annually**

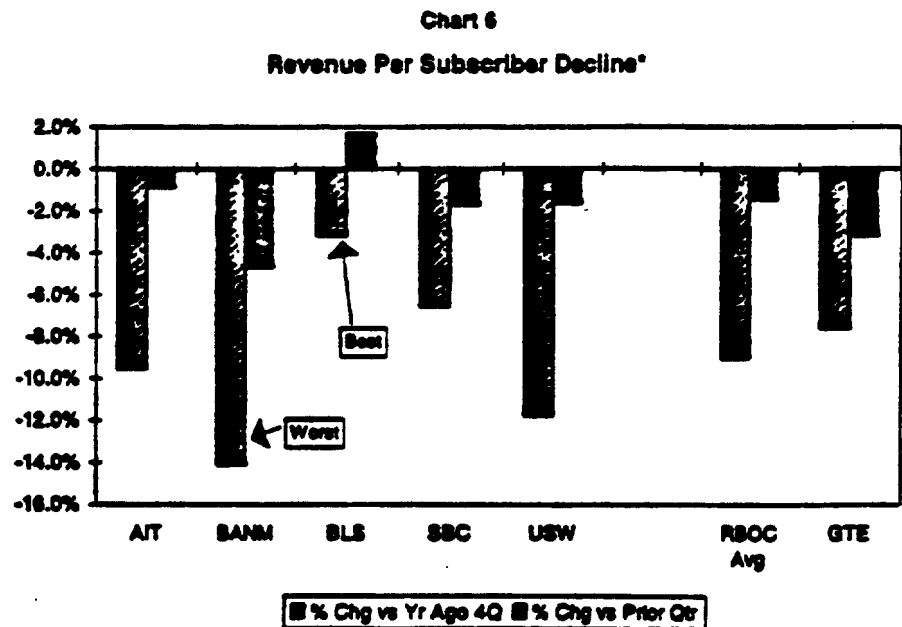


Table 10
Cellular Penetration Gains (Annualized)
 (% of Total Population)

	<u>4Q85</u>	<u>3Q85</u>	<u>4Q84</u>
Ameritech	4.08%	2.07%	3.00%
Bell Atlantic/NYNEX Mobile	2.74%	1.64%	2.31%
BellSouth	3.03%	1.10%	2.31%
SBC	3.05%	1.81%	2.62%
U S WEST Media	3.98%	2.13%	2.98%
RBOC Avg	3.38%	1.71%	2.64%
GTE	1.18%	1.05%	2.35%

* Penetration-gain data reflect net subscriber additions, (annualized/adjusted for acquisitions), divided by population in properties. All data are based on POPs and subscribers in controlled markets, except for BLS, PAC, and SBC, which are measured on an equity basis, adjusting for percent ownership in properties. NA = Not applicable.

Source: Company Reports and Merrill Lynch Estimates

Table 11
Cellular Revenue Per Subscriber Trend
 (% Change)

	<u>Est Rev/Sub</u>	
	<u>vs 4Q84</u>	<u>vs 3Q85</u>
Ameritech	-9.5%	-0.9%
Bell Atlantic/NYNEX Mobile	-14.1%	-4.7%
BellSouth	-3.2%	1.7%
SBC	-6.6%	-1.7%
U S WEST	-11.8%	-1.8%
RBOC Avg	-8.0%	-1.5%
GTE	-7.8%	-3.2%

Source: Merrill Lynch Estimates

Table 12

RBOCs and GTE - Domestic Cellular Subscriber Growth
(Thousand of Subscribers at Quarter's End)

	9Q95	9Q94	Annual Growth	9Q95	Sequent. Growth
Ameritech	1891	1299	45.6%	1674	13.0%
Bell Atlantic/NYNEX Mobile	3356	2340	43.4%	2973	12.9%
BellSouth	2847	2156	32.1%	2544	11.9%
SBC	3659	2979	22.8%	3367	9.0%
U S WEST	1463	968	51.1%	1289	15.3%
RBOC Avg			39.0%		12.2%
GTE	3011	2339	28.7%	2854	5.5%

*Normalized to eliminate effect of restructured partnership arrangement

Table 13

RBOCs and GTE - Domestic Cellular Revenues
(Quarterly Revenues in \$ Millions)

	9Q95	9Q94	Annual Growth	9Q95	Sequent. Growth
Ameritech	NA	NA	NA	NA	NA
Bell Atlantic/NYNEX Mobile	537	422	27.3% *	496	8.2%
BellSouth	507	391	29.5%	495	2.4%
SBC	808	488	24.5%	597	NA
U S WEST	230	179	28.7%	223	3.3%
RBOC Avg			28.5%		4.6%
GTE	537	424	26.7%	530	1.3%

* Revenues as reported. BSNM and GTE figures include cellular service, equipment sales, and paging. BellSouth and U S WEST figures are cellular service only.
NA = Not Available.

Ameritech
AIT - \$59 5/82

**4Q In-Line and Up
11% Year Over Year...**

**Better than Expected
Top Line Growth Was
Offset by Higher than
Expected Operating
Expenses**

**Interest and Other
Expenses Lower than
Expected**

**Fourth Quarter
Normalization**

Q/Q Ratio	Shares Out	EPS		EPS		EPS		EPS Growth Rate
		1994A	1994E	1995A	1995E	1997E	1996E	
B-2-1-7	554	\$0.90	\$0.81	\$3.41	\$3.75	\$4.15	10.0%	10.8%

* EPS figures are on recurring basis and thus do not reflect one-time items.

- Ameritech reported fourth quarter EPS of \$0.74, including a one-time restructuring charge of \$0.16. Excluding this one-time charge, Ameritech earned \$0.90/share, equal to our estimate and up \$0.09 or 11% from the year ago fourth quarter, its strongest quarterly growth ever and its ninth straight quarter of double-digit earnings growth. For full year 1995, recurring EPS totaled \$3.41, up 11% from 1994's \$3.07. We made no change to our 1996 and 1997 estimates of \$3.75 and \$4.15, respectively.
- Ameritech grew total revenues 11% y/y, well above our forecasted growth of 7.4%. The strong growth was driven by a 33.7% increase in "Directory and Other" which includes wireless revenue growth and about \$75 million (10 percentage points of growth) in revenues from Ameritech's new alarm monitoring business. Offsetting the better than expected revenue growth was an 11% increase in normalized operating expenses, also well above our forecast of 4% driven by a 22% increase in "other operating expenses" which included \$70 million of security monitoring expenses, increased expenditures on marketing, customer service and systems development, as well as about \$70 million in year-end accounting adjustments and accruals. Taxes other than income dropped 25% year-over-year due to property tax adjustments in Illinois and Ohio. On-going headcount reductions drove employee related expenses down by 1.9% y/y vs. a 4.1% increase in 3Q — total employees declined 1.2% y/y and Network employees declined 7.5% from year-end 1994.
- Normalized operating income grew 10.7% y/y, lower than our forecast of 15%, but below the line expenses were lower than expected, bringing EPS back in-line with our forecast. Interest expense totaled \$113 million vs. our forecast and the third quarter's \$119 million, while other income jumped to \$79 million from \$43 million in the year-ago quarter and \$47 million (normalized in 3Q) due to a leveraged ESOP gain of about \$12 million and increased contribution from international investments, primarily in New Zealand, Hungary and Poland. The effective tax rate of 33.2% was lower than our forecast of 35.5% as Ameritech utilized international tax credits in the quarter. We continue to forecast an effective tax rate of 35.5% going forward.
- Ameritech made a number of adjustments and "true-ups" in 4Q. We highlight the following: (1) a \$13 million depreciation expense "true-up" in Illinois; (2) a \$27.4 out-of-period reduction in property taxes in Illinois and Ohio; (3) a \$70 million increase in expenses for end-of-year accruals and accounting adjustments; (4) a \$12 million gain in its leveraged ESOP plan; and (5) utilization of international tax credits that reduced Ameritech's effective tax rate. We are highlighting these items solely for the purpose of forecasting going forward, but are not normalizing 4Q results — in our view, such adjustments occur frequently in the fourth quarter and any net one-time gain/loss in 4Q would be offset by the appropriate restatement of the three prior quarters' recurring EPS, making it a wash for the full year. Therefore, we are only normalizing 4Q results for the \$0.16 restructuring charge.

**Strong Revenue
Growth was Driven
by Very Strong Line
Growth...**

- Access lines grew a very impressive 4.5%, better than our forecast and the third quarter's 4.4%. Total line growth was stimulated by a 20 basis point acceleration in residential line growth which jumped from 2.9% in 3Q to 3.1% in 4Q due to rapid growth in second line installations. About 346,000 residential second lines were added in the past 12 months bring second line penetration to 11% by the end of the fourth quarter. Total (business and residential) additional lines grew 21% year-over-year — of the 818,000 total lines added in 1995, about 400,000 were additional lines. Business lines grew a strong 7.2%, in line with the third quarter's trend. The increased marketing effort for second lines is reflected in the 22% increase in other operating expenses, the majority of which is marketing related.

**and LD Access
Minutes of Use
Growth**

- Access minutes of use growth accelerated to 9.1% year-over-year in the fourth quarter, better than our forecast and the third quarter's 8.7%. Access revenues, however, were about flat with the year ago quarter reflecting about \$64 million in price cuts in intra and interstate access rates including the very large FCC-mandated cut effective August 1, 1995. Toll messages grew 5.3% year-over-year, an improvement from the third quarter's 2.4% decline. Toll revenue, however, increased by only 2.9% year-over-year due to continued toll rate reductions.

**Cellular Adds
Significantly Better
than Forecasted**

- Ameritech reported a 46% year-over-year increase in cellular subscribers, a slowdown from the third quarter's 47% growth, consistent with an expected industry wide slowdown as the subscriber base gets larger. In term of net adds, however, Ameritech had its strongest quarter ever. Ameritech added 217,000 cellular subscribers for an annualized penetration gain of 4.1%, significantly better than our forecast of 195,000 adds and penetration gain of 3.7%. Average revenue per subscriber remains stable in the \$55-60/month range — a trend better than the industry average decline of about 10% year-over-year, and a trend we attribute to Ameritech's high quality subscriber base — churn was less than 1% per month, remarkably half the industry average.

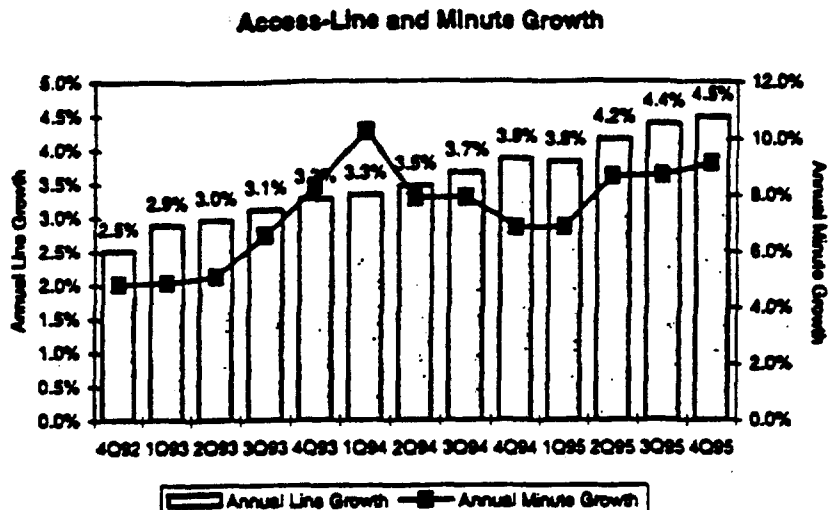
**Other Items to note:
Security Monitoring,
Long Distance and
Cable**

- In early October, Ameritech completed the acquisition of National Guardian, a security monitoring system with 1994 revenues of \$250 million, and the acquisition contributed positive operating income and cash flow in 4Q.
- Ameritech Communications, Inc., Ameritech's long distance subsidiary, continues to prepare for a long distance waiver — it employs about 300 people and has applied for local exchange authority in Grand Rapids and Chicago, allowing for bundled local and long distance offerings as a separate subsidiary.
- Ameritech also continues to expand its video initiatives and employs about 480 people for new media initiatives. Ameritech has been granted cable franchises in 9 cities, with another 30 cities planned.

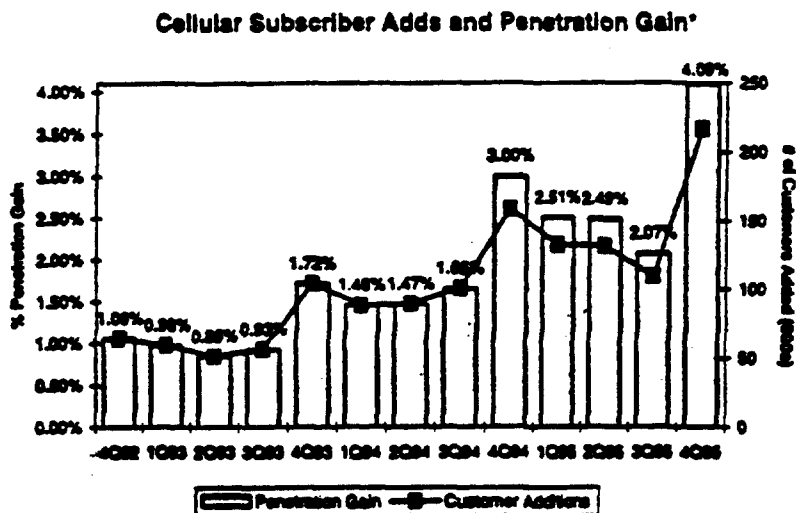
**6% Dividend Increase
— A Good Sign of
Things to Come**

- Finally, On December 20, Ameritech's Board of Directors voted to raise the quarterly dividend to \$0.53 from \$0.50 for an annual dividend of \$2.12 vs. \$2.00 — a 6% increase. The 6% increase was at the high end of our 5-6% dividend growth forecast and well above the consensus forecast of 4%. The \$2.12 dividend implies a 1996 payout ratio of 56.5% based on our 1996 EPS estimate of \$3.75 and a dividend yield of 3.6%. We view the increase as a sign that the company's management shares our positive view of what the future holds for Ameritech (and the other RBOCs). Ameritech's 6% increase is the largest by any RBOC since 1991 and is Ameritech's 12th consecutive annual dividend increase. Ameritech's low payout ratio, combined with a 5-year EPS growth forecast of 10%, means strong dividend growth in the 6+% range is likely to continue for at least the next few years.

**Ameritech:
Acceleration in Both
Line and Minute
Growth**



**RBOC Leading
Cellular Gains in 4Q**



*Penetration-gain reflect net subscriber additions (annualized) divided by population in properties.

**Investment
Conclusion**

We continue to rate Ameritech shares Accumulate (2) in the intermediate term and Buy (1) in the long-term (B-2-1-7) because its valuation is very attractive (P/E 3% below the S&P 500), it is achieving 10% EPS growth before counting the likely boost from long distance entry in a few years, it has already obtained price cap regulation throughout its states, and its payout ratio is second lowest of the group and low enough to anticipate accelerating dividend growth going forward. It has aggressive plans for entry into long distance as evidenced by an already-established long distance subsidiary and business plan. Ameritech also continues to expand its video initiatives and employs about 480 people for new media initiatives. We see a potential for 22% price appreciation in the next 12 months.

Bell Atlantic BEL - \$68 3/8

ORQ Rating	Shares Out	EPS		EPS			EPS Growth Rate	
		4Q94A	4Q94A	1995A	1995E	1997E	94/95E	97/95E
B-2-2-7	483	\$0.90	\$0.76	\$3.88	\$4.20	\$4.55	8.3%	8.3%

* EPS figures are on recurring basis and thus do not reflect one-time items.

* EPS figures are on recurring basis and thus do not reflect one-time items.

(Note: All income statement items reflect the deconsolidation of Bell Atlantic Mobile following the completion of the BAM/YNEX Mobile joint venture on July 1. BAM is no longer consolidated and is instead reported as equity income. All our numbers have been restated to reflect this change.)

**4Q Recurring EPS
\$0.03 Better than
Expected, Raised
'96E & '97E**

- Bell Atlantic reported 4Q EPS of \$0.89, including a \$0.01/share non-recurring charge for debt refinancing. Excluding this charge, recurring EPS were \$0.90 in 4Q, up 18% from \$0.76 (excluding \$0.04 peso charge) in 4Q94, \$0.03 above our estimate, and \$0.02 above consensus. 1995 recurring EPS totaled \$3.88, up 10.2% from \$3.52 in 1994. We raised our 1996 & 1997 estimates by \$0.05 each to \$4.20 (8.3% year-over-year growth) and \$4.55 (8.3% year-over-year growth).

**Revenue Growth
Better than Expected,
Expenses Flat Y/Y,
Tax Rate Lower than
Expected**

- Excluding discontinued operations, total revenues grew 1.6% year-over-year, better than our forecast of 0.5% due to stronger than expected network revenue growth. Value added services revenue grew 13.8% vs. our forecast of 8% and up from 11.4% growth in the third quarter. This growth was stimulated by an aggressive Caller ID promotion, which included a free ID "Box" give away. Caller ID penetration is now about 12.5%. Normalized operating expenses were flat year-over-year, slightly worse than our forecasted 1.5% decline, partially due to the Caller ID/vertical services promotion. Depreciation was up only 1.0% (normalized) from the year-ago. Operating income totaled \$692 million, up 8.0% year-over-year (excluding the effect of discontinued operations) and in-line with our forecast. Bell Atlantic's effective tax rate was 36.4% vs. our forecast of 38% and 3Q's 37.6%. We now forecast an effective tax rate of 37% going forward vs. our prior forecast of 38.0%.

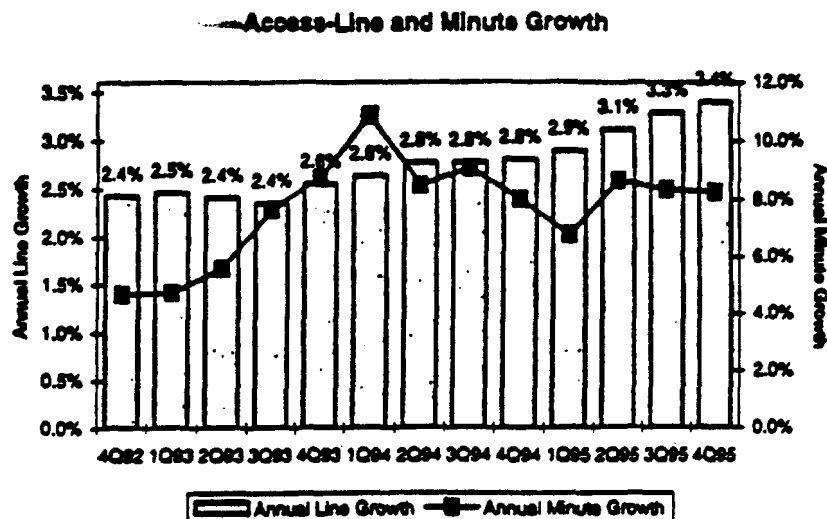
**As Expected, Line
Growth Accelerated
Slightly, Minute
Growth Decelerated**

- Bell Atlantic's line growth accelerated to 3.4%, in line with our estimate and 10 basis points better than the third quarter's 3.3% growth rate. The growth resulted from a 2.4% increase in residential lines (up from 3Q's 2.2%) as a result of strong second line adds. Business line growth continued at 3Q's 5.5% rate. Access minute growth decelerated slightly to 8.2% from 8.3% in the third quarter. Intrastate access minutes increased 13.5%. Toll messages increased 1.8% year-over-year, an improvement from 3Q's 1.4% decline as Bell Atlantic has slowed market share loss (which boosts intrastate access minutes). Competitive toll rate reductions and expanded local calling areas contributed to a 3.6% decline in toll revenues. Bell Atlantic's average toll rate in New Jersey (its most competitive market) is now about \$0.08/minute.

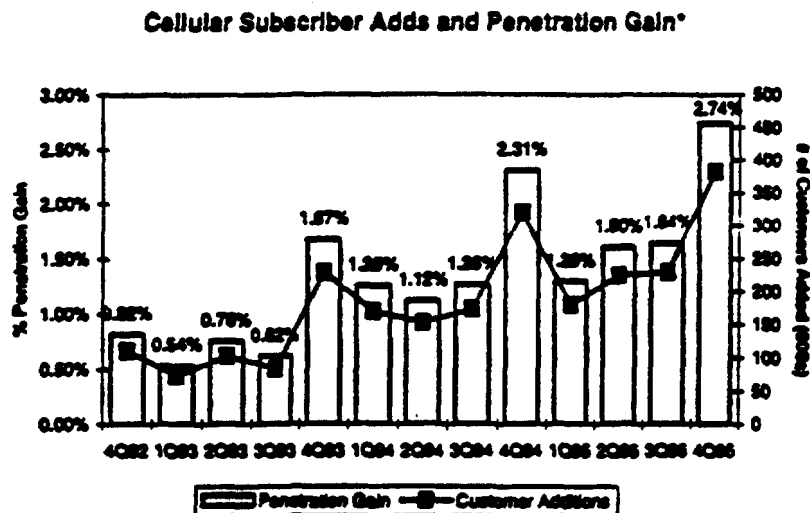
**Wireless Better than
Expected, 43.4% Y/Y
Growth**

- On a combined basis, BANM added 383,000 subscribers for an annualized penetration gain of 2.8%, above our forecast of 375,000 and 4Q94's 336,000. Subscribers grew 43.4% year over year to 3.36 million for a penetration rate of 6.0%. Revenues grew 27.3% year-over-year due to a 14% year-over-year decline in revenue per subscriber. This decline is the result of lower rate per minute roaming agreements reached by BANM with service providers along the east coast. On the positive side, and clearly reflecting the benefits of the merger, operating cash flow more than doubled to \$199 million from \$85 million in 4Q94. Operating cash flow margin improved to 44% from 24% in the year-ago fourth. On a proportionate basis, BANM contributed \$91 million to pre-tax income (about \$0.13/share), up from only \$14.9 million in the year ago quarter.

**Bell Atlantic:
Line Growth
Accelerates, Minute
Growth Slows
Slightly**



**BANM: Strong
Gains in 4Q**



* Penetration-gain reflect net subscriber additions (annualized) divided by population in properties.

**Investment
Conclusion**

We continue to rate Bell Atlantic shares Accumulate (B-2-2-7) given its strong regulatory environment and aggressive plans for entry into long distance. Bell Atlantic's shares currently trade at a 1% discount to the S&P 500's 1996 P/E multiple and we see a potential for 16% price appreciation over the next 12 months. Our target price of \$79 is based on a target 1996 P/E multiple of 18.9x (5% premium to our targeted RBOC average multiple). As shown by the BAM/NYNEX mobile merger, Bell Atlantic is ready to take advantage of opportunities to achieve synergies, increased earnings and competitive advantages of an expanded geographic coverage area.

BellSouth **BLS - \$40 3/8**

Highlights:
4Q a Penny Above,
No Changes

Stronger Than
Expected Revenue
Growth,

Operating Expenses
Up Too, But Less
Dilution from RAM
and Other
Investments and
Lower Tax Rate

Line & Access Minute
Growth Slowed But
Still Very Strong;
Marketing Costs for
Vertical Services and
Second Lines is
Paying Off

GRG Rating	Shares Out	EPS		EPS		EPS		EPS Growth Rate
		4Q95A	4Q94A	1995A	1995E	1997E	94/95E	97/95E
B-2-2-7	994	\$0.57	\$0.52	\$2.24	\$2.45	\$2.67	9.5%	8.7%

* EPS figures are on recurring basis and thus do not reflect one-time items.
All numbers are before 2:1 stock split effective November 8, 1995

- BellSouth earned recurring EPS of \$0.57 in the fourth quarter, up 9.6% from the year-ago recurring \$0.52, a penny above our estimate and \$0.02 above consensus. BellSouth reported a loss of \$0.16/share in the fourth quarter including a \$0.67 one-time charge for workforce restructuring and a \$0.06 charge for debt refinancing. For the full year, BellSouth earned \$2.24 on a recurring basis, up 8.2% from \$2.07 in 1994. We made no change to our 1996 or 1997 estimates of \$2.45 (9.5% growth) and \$2.67 (8.7% growth), respectively.
- The fourth quarter's 9.6% y/y EPS growth was driven by total revenue growth of 8.4% (or 7.5% net of directory accounting changes) which was much better than our forecast of 5.5%. Telco revenue growth of 6.1% was driven by local revenue (including value added services) of 7.4% and interstate access revenue growth of 10.1% (BLS' sharing accrual were down \$73 million vs. the year-ago 4Q as the FCC allowed a full price cap option on interstate access beginning in August 1995). Directory & Publishing revenues grew 26.2% y/y, 9 pct. points of which was due to a change in accounting as required when BellSouth's moved off of FAS 71 (now required to recognize all revenue when book is issued instead of allocating revenues over the year of the issue). For the full year vertical services (memory call, caller ID, etc.) revenues grew 20.5% to \$773 million.
- The strong revenue growth drove operating expense growth to 8.8% in 4Q (est. 7.0% excluding Hurricane Opal related costs) vs. our forecast of 5.0%. SG&A expenses were up 14.2%, worse than 3Q 10% growth due to greater advertising expenditures designed to accelerated vertical service and cellular growth. In addition, BellSouth increased expenditures on network software used for vertical service features. Cost of Services & Products increased 7.6% vs. our forecast of only 2.5% due to promotions related to BellSouth's brandname change and expenses incurred to restore service and repair lines following Hurricane Opal. Thus, normalize operating income grew 4.1% y/y, lower than our forecast of 7%. Interest expense was about \$12 million higher than we expected (\$192 million) due to some overlapping of interest payment periods when BellSouth converted short-term into long term debt. We expect a quarterly run rate of around \$180 million going forward. Other expense (normalized) decreased by about \$23 million year-over-year due to greater cellular equity income and less RAM dilution. Normalized pre-tax income grew only 4.2% y/y, vs. our forecast of 8%. BellSouth's effective tax rate was only 37.5%, lower than our forecast of 40% due to year-end adjustments and credits. We forecast an effective tax rate of about 39.5% going forward.
- Line growth decelerated to 4.5% from 4.7% in the third quarter, below our forecast of 4.7% due to a slow down in new housing construction. The 4.5%, however, is still one of the strongest growth rates of the RBOC group. Residential second line growth continues to accelerate and drive residential line growth. Residential second lines installed grew 21% year-over-year to 1.3 million (9.5% penetration) and contributed about \$350 million to revenues in 1995. Caller ID subscribers grew 120% to over 2 million subscribers and memory call (voice mail) subscribers grew 32% to 1.6 million. Business line growth accelerated to 7.9% from 7.7% in the third quarter, with Georgia, North

***Extremely Strong
Cellular Gains —
Both Domestic...***

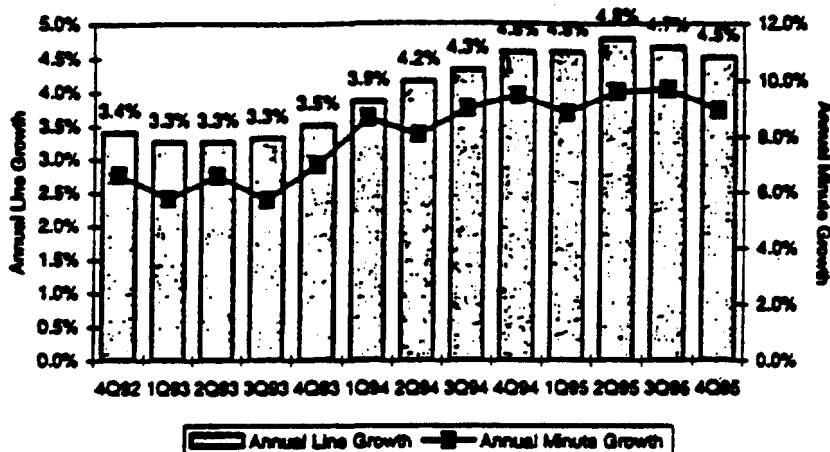
And International

Carolina and Kentucky reporting the strongest growth rates (over 8.5%). Access minute growth decelerated slightly to 9.0% from 9.7% in the third quarter. Interstate access minutes grew 7.7% and intrastate access minutes grew 13.1% as a result of 10XXX dial around — which caused a 16.8% year-over-year decline in IntraLATA toll messages.

- BellSouth added 303,000 domestic cellular subscribers in the fourth quarter for an annualized penetration gain of 3.0%, significantly better than our forecast of 280,000, the third quarter's 110,000 and the year ago fourth quarter's 226,000. Total domestic subscribers grew 32% y/y to reach over 2.8 million for a total penetration of over 7.1% vs. 5.5% at the end of 1994. Domestic cellular revenues grew 29.5% and operating cash flow increased 35% due to a year-over-year improvement in OCF margin from 40.5% in 4Q94 to 42.2% in 4Q95. Average revenue per domestic subscriber declined only 3% to \$61/month from \$63 in 4Q94, much better than our estimated industry average decline of 9%.
- International cellular subscribers grew 81% year-over-year and revenues grew 39%. In Latin America, revenue per subscriber averaged \$104/month, down 11% annually, and \$40/month higher than domestic subscribers. Latin American cellular contribution dropped from about \$0.03/share in 3Q and \$0.02 in the year-ago quarter to less than a half a cent in 4Q due to an \$11 million loss from currency devaluation in Venezuela.

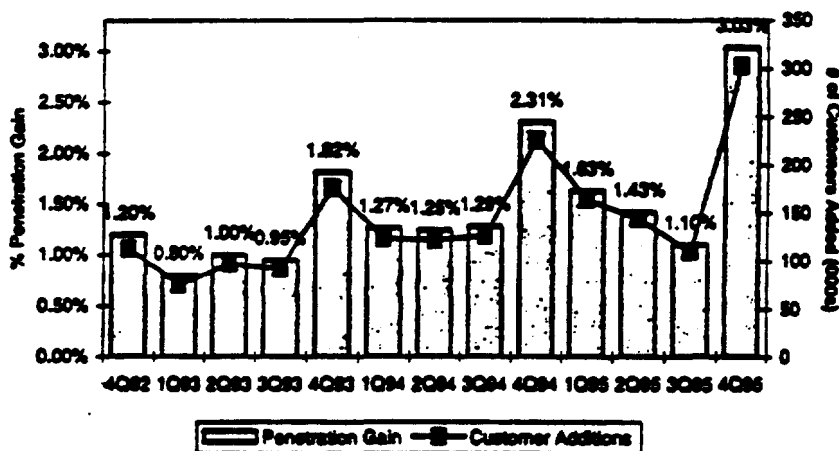
**BellSouth: Line
Growth Slows But Still
Very Strong**

Access-Line and Minute Growth



**Cellular Gains
Recover in 4Q**

Cellular Subscriber Adds and Penetration Gain*



*Penetration-gain reflect net subscriber additions (annualized) divided by population in properties.

**Investment
Conclusion**

We rate BellSouth's shares Accumulate in the intermediate term and long-term (B-2-2-7) because of its below average competitive risks, low likelihood of large broadband investments, below (RBOC) average 1996 EBITDA multiple, below average dividend payout ratio and recent decision to begin raising dividends again after 4 1/2 years of no dividend growth. We also note that dilution from RAM, GSM buildout in Germany, Optus and other international investments may have already peaked — which could lead to stronger year-over-year growth going forward. Note: On February 13 we lowered our long-term rating on BellSouth shares from Buy (1) to Accumulate (2) based on price. Since mid-July, BellSouth shares had appreciated about 45% vs. the RBOC average of 35% and the S&P 500's 18% appreciation.

NYNEX **NYN - \$52 1/8**

Highlights:
\$0.04 Above; Raised
'96E and '97E by
\$0.05 Each

Total Revenues Grew
4.3% Y/Y; Operating
Expenses Up 1.9%,
Both In Line With Our
Forecast

Strong Line Growth
Acceleration

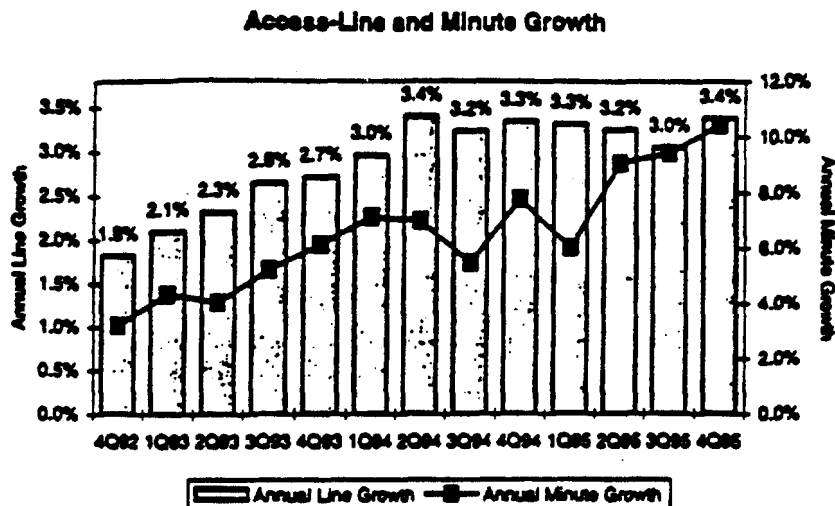
Wireless Contribution
Better Than Expected

CRQ Rating	Shares Out	EPS		EPS		1997E	EPS Growth Rate	
		4Q94A	4Q94A	1995A	1995E		94/95E	97/95E
B-2-2-7	432	\$0.88	\$0.78	\$3.28	\$3.55	\$3.85	8.2%	8.4%

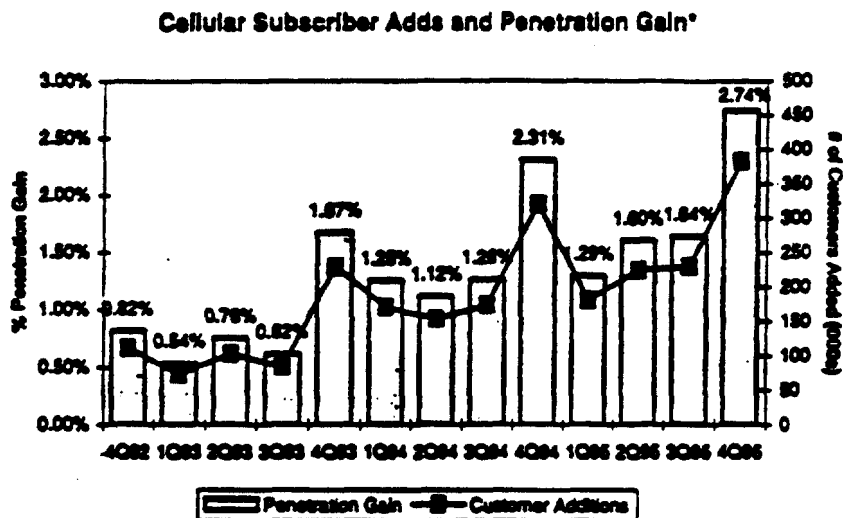
* EPS figures are on recurring basis and thus do not reflect one-time items.

- NYNEX reported 4Q EPS \$0.55, including one-time items netting to a \$0.33 one-time charge. Excluding this charge, NYNEX earned \$0.88, \$0.04 above our estimate, \$0.05 above consensus and 12.8% above the year ago recurring \$0.78. Recurring EPS for 1995 totaled \$3.28, up 9% from 1994's recurring \$3.01. We raised our 1996 & 1997 estimates by \$0.05 each to \$3.55 (8.2% growth) and \$3.85 (8.4% growth), respectively.
- Local service revenue grew 1.1% year-over-year, a significant deceleration from 3Q's 2.7% as 4Q was impacted by \$24 million in local rate reductions (compared to only \$1 million in 3Q). Total rate impact in 4Q, including toll and access rate reductions net of a decrease in required set-asides, amounted to negative \$16.7 million, slightly worse than 3Q's \$14.8 million. Normalized operating expenses increased 1.9% y/y, also in-line with our forecast. Maintenance & Support grew 5.4% vs. our forecast of 1.5% but "other" operating expenses grew only 8.8% vs. our forecast of 15%. SG&A increased by less than 1% despite a \$10 million y/y increase in advertising expenses. Normalized operating income increased 11.8% y/y, in line with our forecast. One-time items, other than the special pension enhancement charge of \$226 million (\$0.33/sh), offset each other. Normalized interest expense of \$180 million was \$13 million lower than our forecast and accounts for about \$0.02 of the positive surprise vs. our estimate. Greater than expected contribution from BANM (\$41 million vs. our forecast of \$35 million) accounted for another \$0.01 of the difference and the remaining \$0.01 can be attributed to a lower than expected effective tax rate (34% vs. 35% forecasted).
- NYNEX's line growth accelerated to 3.4%, 40 basis points better than our forecast and 3Q's 3.0%. Residential lines grew 1.8% (equal to 3Q's rate) and business lines grew 6.7%, up 90 basis points from 3Q's 5.8% growth. Access minute growth accelerated to 10.4% from 9.4% in 3Q. Intrastate access minutes grew 21.2%, up from 3Q's 16.5%. NYNEX continues to prepare for intralata presubscription (beginning in March 1996) with added promotions and pricing initiatives. Intralata toll revenues grew 2.7% y/y, despite \$11.5 million in rate reductions, an improvement from the year-over-year declines of around 4% reported in the first three quarters of 1995, indicating that perhaps NYNEX customer retention initiatives are working.
- On a combined basis, BANM added 383,000 subscribers for an annualized penetration gain of 2.8%, above our forecast of 375,000 and 4Q94's 336,000. Subscribers grew 43.4% year over year to 3.36 million for a penetration rate of 6.0%. Revenues grew 27.3% year-over-year due to a 14% year-over-year decline in revenue per subscriber. This decline is the result of lower rate per minute roaming agreements reached by BANM with service providers along the east coast. On the positive side, and clearly reflecting the benefits of the merger, operating cash flow more than doubled to \$199 million from \$85 million in 4Q94. Operating cash flow margin improved to 44% from 24% in the year-ago fourth. On a proportionate basis, BANM contributed \$41 million to pre-tax income (about \$0.06/share).

**NYNEX: Both Line
and Minute Growth
Accelerated in 4Q**



**BANM: Strong
Gains in 4Q**



*Penetration-gain reflect net subscriber additions (annualized) divided by population in properties.

**Investment
Conclusion**

We continue to rate NYNEX's shares B-2-2-7. We raised our 1996 estimate by \$0.05 as the strong performance in 1995 gives us greater confidence that NYNEX will be able to meet its goal of 7-10% long-term EPS growth. We believe NYNEX will continue to participate in the expected upward movement of the RBOC group, however we remain somewhat concerned over the short-term perception impact of the very pro-competition regulatory environment in New York (including intralata dialing parity and presubscription beginning in March 1996).

Pacific Telesis /p/ PAC - \$30 1/4

Highlights:
**4Q \$0.01 Better Than
Expected; Lowering
'97E To Reflect More
PCS Dilution**

**Toll Share Loss
Stabilized at 6%**

**Revenues Lower than
Expected, Operating
Expenses In-Line,
Lower Interest
Expenses and Taxes
Helped Bottom Line**

**Line Growth
Accelerated
Significantly and Was
Better Than Expected**

**Adjustments to 4Q
Reported Earnings**

Q/Q Ratio	Shares Out	EPS		EPS		EPS Growth Rate	EPS Growth Rate
		3Q96A	4Q96A	1996A	1997E	3Q96E	4Q96E
B-2-2-8	428	\$0.54	\$0.62	\$2.46	\$2.50	\$2.35	1.6%

* EPS figures are on recurring basis and thus do not reflect one-time items.

- In a very messy and difficult to analyze 4Q, Pacific Telesis (PacTel) earned a RECURRING \$0.54/share, down 13% year-over-year, in line with consensus and \$0.01 above our estimate of \$0.53. Full year recurring earnings totaled \$2.46, also \$0.01 above our estimate. We made no changes to our 1996 estimate of \$2.50, but we lowered our 1997 estimate to \$2.35 from \$2.47 as we now expect PCS to be more dilutive than we had forecasted earlier.
- PacTel's intraLATA toll share losses appear to have leveled off at 6%, but that loss combined with a significant lag between usage stimulated by toll rate reductions (elasticity) and the actual rate reductions of \$162 million resulted in a 39.3% year-over-year decline in toll revenues. This decline was worse than our forecast of 32%. Pacific Telesis loses approximately 9 cents per toll minute shifted to a competitor's network, but recovers about 2.8 cents/minute (i.e., only 31%) in intrastate access revenue (1.4 cents at each end of the call). Despite the shift from toll minutes to access minutes (the latter increased 21.3% year-over-year), intrastate access revenues only grew 3% year-over-year (normalized) due to about \$45 million in rate cuts.
- The greater than expected decline in toll revenues led to a total revenue decline of 3.1% y/y, worse than our forecast of a 1.7% decline. Total operating expenses declined 1.0% y/y (normalized), in line with our forecast and driven by a 8.7% drop in G&A. Normalized operating income declined 11.3% y/y, worse than our forecasted decline of 4.4%. Normalized operating margin dropped to 19.3% from 24.7% in 3Q and 21.1% in 4Q94, due primarily to the increased software expense. Interest expense totaled only \$92 million, down \$25 million sequentially due to a reclassification of interest charged on construction to "other expense" (\$11 million) combined with lower rates. Similarly, "other expense" increased by \$44 million sequentially, partially due to the reclassification described above (\$6 million) and an \$18 million debt refinancing expense. The effective tax rate was only 35.5%, significantly lower than our 38% forecast due to year-end adjustments and investment tax credits utilized during the quarter. Our model continues to assume an effective tax rate of 38% going forward.
- PacTel reported line growth of 3.0%, up 30 basis points from 3Q's 2.7% and better than our forecast of 2.8%. Residential line growth was 2.1%, up from 1.8% in 3Q and business line growth accelerated to 4.9% from 4.4% in 3Q. PacTel residential line growth is still well below the RBOC average of 2.8% as new home construction continues at an all time low in California. Access minutes grew 11% y/y, equal to our forecast and in-line with 3Q. PacTel's access minute growth continues at an above average rate as retail-priced intraLATA toll minutes are being lost to AT&T, MCI, etc. that, in turn, boost their usage of wholesale-priced intrastate access minutes — growth for the latter was 21.3% y/y, also in line with 3Q and indicating that share loss has stabilized. Intrastate access growth is also stimulated by "tariff arbitrage" — i.e., long distance carriers shifting usage from 1.8 cents/minute interstate access to 1.4 cents/minute intrastate access.
- Customer Operations & Selling Expense (CO&SE) was understated by \$33 million due to the reversal of expenses for a CPUC mandated consumer education program that PacTel accrued in the third quarter. Therefore we are